

Petition of Western Massachusetts Electric Company)	
for authorization and approval of the issue and sale of)	
long-term debt securities in an amount not to exceed)	
\$105 million in principal, pursuant to G.L. c. 164, § 14,)	D.T.E. 02-49
and exemption from the competitive bidding requirements)	
of G.L. c. 164, § 15.)	
)	

March 21, 2003

TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	ARGUMENT	2
A.	The Company Failed To Seek Authorization And Provide Appropriate Public Notice Under G.L. c. 164, § 17A, To Create And Fund A PSNF Trust	2
B.	Creating And Funding A PSNF Trust Would Not Be In The Public Interest	3
1.	Debt Issue Benefits Are Distinct From The Economics Of Investment In A PSNF Trust	3
2.	The Company Has Not Shown That Funding A PSNF Trust Would Be In The Public Interest	4
3.	The Company’s Other Arguments For Funding A PSNF Trust Lack Merit	5
C.	The Department Should Deny The Company’s Proposal To Enter Into The Financial Derivatives Market	7
III.	CONCLUSION	10

)	
Petition of Western Massachusetts Company)	
for authorization and approval of the issue and sale of)	
long-term debt securities in an amount not to exceed)	D.T.E. 02-49
\$105 million in principal, pursuant to G.L. c. 164, § 14,)	
and exemption from the competitive bidding requirements)	
of G.L. c. 164, § 15.)	
)	

1

and funding a PSNF trust would harm customers. The Department should not authorize WMECo to engage in hedging activities because those activities will create incentives for gaming, unfair dealing, and increased financial risk, all to the detriment of the Company's customers.

II. ARGUMENT

A. The Company Failed To Seek Authorization And Provide Appropriate Public Notice Under G.L. c. 164, § 17A, To Create And Fund A PSNF Trust.

The Company contends that it is not required to petition for Department approval under G.L. c. 164, §17A, to create and invest in a PSNF trust.² Co. Br., pp. 14-16. The Company ignores the plain statutory language of §17A: “ No...electric company shall...invest its funds in the ... securities of ...any...trust unless the... investment is approved in writing by the [D]epartment.” G.L. c. 164, § 17A.

WMECo asserts that the §17A cases cited by the Attorney General are not relevant because they involve investments in separate corporate entities outside of a company's control. Co. Br. , pp. 14-16. WMECo also claims that the Department may approve borrowing to fund trusts within the Company's control under G.L. c. 164, §14, without requiring a request under §17A. *Id.* The statutory language of §17A, however, does not restrict its requirements only to investments in corporate entities that are not controlled by a company. WMECo's case citations, moreover, do not support its claim, since the cases the Company cited were almost all filed and

² The Company originally implied in its Petition that it would use some of the proceeds from the financing to “finance” the PSNF Trust. The Company now indicates that it only wants to use the funds to “manage” the PSNF liability. *Compare*, Petition, p.1 and Co. Br., p. 1. In either case, the Department should specifically deny the Company the authority to invest in a PSNF Trust.

decided under §17A. *Berkshire Gas Company*, D.T.E. 97-107, pp. 1-5 (1998); *Western Massachusetts Electric Company*, D.P.U. 91-129, p. 2 (1991); *Western Massachusetts Electric Company*, D.P.U. 873, p.1 (1981).³ In addition, the Department should not allow the Company to claim that it does not need §17A approval to fund a trust where it has previously petitioned the Department under §17A in other trust investment matters. *Western Massachusetts Electric Company*, D.P.U. 91-129, pp. 1-2, 10 (1991); *Western Massachusetts Electric Company*, D.T.E. 97-108, pp. 1-3 (1998); *Western Massachusetts Electric Company*, D.P.U. 873, p.1 (1981).

The Company suggests that, even if it failed to petition the Department under §17A, the Department can still view the petition as “falling under section 17A and on its own initiative, [approve] it as such.” Co. Br., p16. The Company’s position is inconsistent with due process and fair public notice. WMECo’s suggestion would burden the Department and interested parties reading legal notices with the task of guessing the petitioner’s intentions. The Department should require the Company to adhere to statutory requirements relating to investments in trusts and should not authorize WMECo to invest in a PSNF trust in this case.

B. Creating And Funding A PSNF Trust Would Not Be In The Public Interest.

1. Debt Issue Benefits Are Distinct From The Economics Of Investment In A PSNF Trust.

WMECo claims that the proposed debt issue, combined with the creation and funding of a PSNF trust, would be in the public interest because that would lower the overall weighted cost

³ WMECo did cite one case that did not explicitly mention §17A, but even in that case the Department implicitly followed §17A, relying on cases decided under the §17A standard of review. See, *Western Massachusetts Electric Company*, D.T.E. 99-36, p.1 (1999), citing *Western Massachusetts Electric Company*, D.T.E. 97-108 (1998).

of capital for ratemaking purposes, reducing costs to customers. Co. Br., pp. 6-12. The Company's argument conflates two separate issues: 1) the benefits associated with the proposed issuance of \$105 million in debt; and 2) whether creating and funding a PSNF trust would be in the public interest. *Id.*

WMECo cannot reasonably link PSNF trust investment to the debt issuance where it has already recovered the balance of PSNF funds from customers. Only by artificially linking the creation of a trust with the benefits of the proposed bond issuance can the Company claim there is no harm to customers from funding a PSNF trust.

2. The Company Has Not Shown That Funding A PSNF Trust Would Be In The Public Interest.

WMECo seeks, in conjunction with the creation and funding of a PSNF trust, to eliminate the credit to unrecovered stranded cost. Eliminating this credit would cost consumers over \$5 million each and every year until DOE takes all of the spent fuel. AG Br., pp. 6-7. The Company does not refute the magnitude of this harm to customers. WMECo instead argues that the Department should ignore the \$5 million figure because the Attorney General presented the calculation in his brief, and not through witness testimony. Co Br., pp. 16-17. The calculation yielding the \$5 million figure is simply the investment balance times interest rate. The numbers used all appear in the record: Tr. 1, p. 34 (U.S. Treasury Bill rate); Tr. 1, p. 54 (PSNF liability balance and overall weighted cost of capital); and Tr. 1, pp. 59-60 (interest expense formula). WMECo has not shown any error in the calculation. The Department should use the \$5 million per year figure in evaluating whether funding a PSNF trust would be in the public interest.

The Company suggests that customers are likely to benefit from excess investment

income following payment of the PSNF liability and dissolution of a PSNF trust. Co. Br., p.8.

WMECo does not quantify the alleged benefits to compare them to the immediate and continuing impact of the \$5 million per year cost to customers. The trust might not terminate for decades, and so the net present value of these alleged benefits is unquantified and speculative. Indeed, the Company undercuts its own assertion by conceding the possibility that the trust may have a shortfall. Tr. 1, p. 64; Exh. WM-1, p.10. The Company's assertion that its money market instruments would exceed a T-bill rate of "1 percent or 2 percent or 3 percent or 20 percent" has no support in the record.⁴ Tr. 1, p. 64.

Customers would not experience the main benefit from "rebalancing" the capital structure, the lowering of the overall weighted cost of capital, until the Department adjusts WMECo's capital structure in a base rate case. Tr. 1, p. 60. Customers thus may have to wait several years before they experience any benefits to offset the \$5 million annual cost.

WMECo's alleged benefits of funding a PSNF trust are thus speculative, unquantified, and far outweighed by the \$5 million harm.

3. The Company's Other Arguments For Funding A PSNF Trust Lack Merit.

WMECo also argues unsuccessfully that: (1) the "refinancing" of the proposed trust would ensure that the costs of the nuclear generation liability do not burden current or new customers; and (2) a PSNF trust would correct the Company's ratemaking capital structure,

⁴ The Company argues that its investment of trust assets in money market instruments is likely to outperform or exceed increases to the PSNF liability accruing interest at the U.S. Treasury Bill rate.

which the PSNF liability has “skewed” away from the bond rating agency capital structure.⁵ Co. Br., pp. 9-13.

First, a PSNF trust is not needed to ensure that the costs of the nuclear generation liability do not burden current or new customers. To the contrary, current customers are already paying, and will continue to pay, for the Company’s past nuclear obligations. The transition charge includes the excess of the Millstone nuclear plants’ net book value over the proceeds from the sale of the units. Customers are also liable for the PSNF obligation whether or not a trust is created. Exh. WM-1, p.10. Since WMECo recovered its investment in the Millstone plants from customers with a return at the Company’s overall weighted cost of capital, customers are entitled to a return on all credits for ratepayer-supplied funds at the Company’s overall weighted cost of capital. *Cambridge Electric Light Company*, D.T.E. 02-76, pp. 9-10 (2003).⁶

Second, funding a PSNF trust is not necessary to “rebalance” or to correct any “skewing” of the capital structure. The Company admits that the ratings agencies, even with the creation of

⁵ The Company also argues that funding a PSNF trust now would allow it to take advantage of the current low interest rates and lower the balance of the liability to be funded. Co. Br., pp. 11-12. Both of these arguments relate to the **timing** of any investment in a trust rather than the **benefits** of a PSNF trust itself. The Company’s contention that interest rates are likely to increase in the future is unsupported; WMECo admitted that it does not know whether interest rates will go up or down. Tr.1, p.64. WMECo consistently ignores the fact that customers have already paid for or otherwise financed the liability. Tr.1, pp.33-34. The amount already collected, with accumulated interest over the years, should be sufficient to pay the obligation. *Id.*

⁶ The Department held in *Cambridge*:

The Company must return the proceeds in a manner that symmetrically mitigates total transition costs, taking into consideration the carrying costs that ratepayers have borne to date for Blackstone [Generating] Station. Therefore, the Department directs the Company to include a symmetrical portion of the proceeds in the residual value credit. The amount of this credit shall be set at a level where, on a going forward basis, the ratepayers will be treated in a manner consistent with the recovery of these charges to date

a PSNF trust, will still consider the PSNF liability as debt on the Company's balance sheet. Exh. WM-2, p.3. The Company could still borrow the \$105 million, and thus improve its capital structure, even if the Department does not authorize the creation of a PSNF trust. WMECo will in time issue other debt financing that should provide similar rebalancing benefits. Incurring additional debt, not the creation and financing of a PSNF trust, is what would correct the Company's skewed capital structure and reduce charges to customers.

The Department should approve the proposed debt issue without authorizing the creation and funding of a PSNF trust. This would enable customers to receive the benefits of the bond issue without the harm of WMECo's proposed lowering of the return on funds that customers have paid to the Company for the PSNF liability.

C. The Department Should Deny The Company's Proposal To Enter Into The Financial Derivatives Market.

WMECo argues that the Attorney's General's concerns with the Company's proposal to enter into derivative trading and his claims regarding the potential for gaming and unfair dealing are "marlarky" that is not supported by the record and amounts to improper testifying on brief. Co. Br., pp. 27. The Company admitted on the record, however, that shareholders would benefit to the detriment of customers under simple and real scenarios of gaming or unfair dealing. Exh. AG-RR-1. Contrary to WMECo's assertions, the Department cannot weed out all Company acts that would work against customers. The Department does not have the ability to oversee each and every Company financing decision to ensure that WMECo is acting in the best interests of customers. The nature of the derivatives trading proposal, where the customers pay at the interest rate associated with the original debt issue while the Company's shareholders can profit

by hedging against that very same debt, establishes a conflict of interest between the shareholders and the customers. Exh. AG-RR-1. Currently, without the proposal, the interests of shareholders and customers are generally aligned when a utility makes investment decisions. WMECo's proposal will destroy that simple, but important relationship. To protect customers, the Department would face the impossible task of second guessing each and every one of the Company's financing decisions.

The record evidence also contradicts the Company's claim that it is seeking to engage in only limited and non-speculative derivative trading. The Company responded to a Department information request: "[r]egarding the use of derivatives to hedge interest-rate risk, WMECo does not wish to seek further department approval, since the application seeks **broad authority** for WMECo to enter into all types of derivative instruments...." (Emphasis added). Exh DTE-1-23; Exh. WM-1, p.15; and Petition, p.8.

WMECo argues that Financial Accounting Standards Board's statement FAS Number 133 ("FAS 133") restricts the Company's derivative trading activities from being speculative on a trade for trade, day for day, year-round basis. The Financial Accounting Standards Board does not have any legal or regulatory authority to restrict a firm's trading. FAS 133 only prescribes how the derivatives are accounted for under Generally Accepted Accounting Principles on those days when the auditor does the accounting. Since WMECo's independent auditors will audit its balance sheet only four days a year, at the end of each quarter, the Company, under its scheme, could do any trading it wants, speculative or otherwise, during the other 360 days of the year.

The record also contradicts the Company's statement that it has a "state of the art" risk management policy **in place**. WMECo's Board of Directors and Northeast Utilities' Board of

Trustees have not yet voted on the draft document, nor approved it to permit implementation.⁷

Tr. 1, p. 92-94, 103-105; Exh. DTE-RR-1; Co. Br., p. 31.

The record also contradicts the Company's claim that it has staffing expertise in derivative trading. Company witness Shoop testified that **only** he and the Corporate Finance Manager, Ms. Cosgel, would conduct the derivative trading on behalf of the Company. Tr. 1, pp. 17-18. Mr. Shoop elaborated that his and Ms. Cosgel's experience in derivative trading entailed "four or five" transactions performed over the past few years. *Id.* That experience hardly constitutes expertise in the complex field of derivative trading.

Finally, the Company claims that the Department has approved derivatives trading activities by an electric utility in *New England Power Company*, D.P.U. 91-267 (1991). New England Power Company ("NEP") sought the ability to hedge interest rates associated with only one bond issue for a limited time period between Department approval and company issuance of the bond. *Id.*, pp.6 and 18. NEP, moreover, passed the benefits (and the costs) of the derivatives trading through to customers, so the shareholders' interests and the customers' interests were aligned. *Id.*, pp.14-15. The Department's order in NEP's financing is thus inapposite to WMECo's proposal in this case.

III. CONCLUSION

For all of the reasons discussed here and in the Attorney General's Initial Brief, the Department should: 1) authorize the Company to issue bonds up to \$105 million; 2) deny the

⁷ The Company provided the Department with a draft of its risk management policies. Exh. DTE-1-28. Thereafter, the Company made material changes to the document. Exh. DTE-RR-1. Until the WMECo and Northeast Utilities Boards approve a final version of the document, current drafts of the document are subject to continued material changes.

Company authority to establish and finance a PSNF trust; and 3) deny the Company authority to engage in derivative trading and hedging activities in light of the potential for gaming, unfair dealing, and increased Company risk.

RESPECTFULLY SUBMITTED,

THOMAS F. REILLY
ATTORNEY GENERAL

By: _____
Wilner Borgella, Jr.
Edward G. Bohlen
Assistant Attorneys General
Utilities Division
200 Portland Street
Boston, MA 02114
(617) 727-2200

Dated: March 21, 2003